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Decision 01-09-063 September 20, 2001

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion Into Competition for Local Exchange Service.	Rulemaking 95-04-043 (Filed April 26, 1995)
Order Instituting Investigation on the Commission's Own Motion Into Competition for Local Exchange Service.	Investigation 95-04-044 (Filed April 26, 1995)

O P I N I O N

We grant the Joint Motion for Adoption of the Proposed Settlement Agreement filed on April 23, 2001, relating to the recovery of Verizon California Inc's (Verizon) Local Competition Implementation Costs. [1] In so doing, we authorize Verizon to recover $12 million over a two-year period beginning January 1, 2002. In this phase of the Local Competition Proceeding addressing implementation cost recovery, we have considered costs for both major

[1] In D.98-11-066, we defined "implementation costs" as expenses incurred in response to a regulatory order implementing the infrastructure to enable Competitive Local Exchange Carriers (CLCs) to compete with the ILEC. Such costs are not intended to enable the ILEC to compete in the local exchange market, but are for the general benefit of CLCs. The ILEC must incur these costs for the benefit of the CLC by virtue of the ILEC's control over essential bottleneck facilities and related processes. The implementation measures associated with such expenses are nonrecurring and necessary to transition to a competitive environment.

incumbent local exchange carriers (ILECs), Pacific Bell Telephone Company (Pacific) and Verizon. In D.00-09-037 we addressed Pacific's costs; the Settlement Agreement addressed in this decision covers Verizon's costs.

I. Procedural Background

The issue of ILEC cost recovery for local competition implementation costs first arose in evidentiary hearings held in this docket during fall of 1995. In March 1996, the Commission issued D.96-03-020 based upon those hearings, determining that it was premature to grant any implementation cost recovery, and deferring consideration of ILEC cost recovery requests until after such costs were actually incurred. The Commission authorized the ILECs to record such costs incurred since January 1, 1996, in memorandum accounts subject to later disposition.

On December 31, 1997, the assigned Administrative Law Judge (ALJ) solicited further comments concerning (1) the basis upon which implementation cost recovery could be justified and what sort of cost recovery mechanism may be appropriate; (2) any modification to the ILEC's accounting and reporting of implementation costs necessary to permit adequate discovery to proceed; and (3) the timing and coordination of any schedule for further Commission consideration of the recovery of implementation costs. Comments were filed on February 20, 1998, and replies on March 6, 1998.

Based upon those comments the Commission issued D.98-11-066, authorizing an interim per-line surcharge to recover 75% of the 1996 reported implementation costs of Pacific and GTE California, Inc. (now renamed as

Verizon California, Inc.)[2] subject to a true-up. In order to qualify for final recovery, the implementation costs had to reflect finished work products that had been prudently and effectively implemented. The Commission noted that evidentiary hearings might be warranted to determine the appropriate level of implementation costs subject to final recovery.

Various parties filed applications for rehearing of D.98-11-066 challenging, among other issues, the legality of the customer surcharge without a finding of reasonableness. The Commission stayed the authorization to recover 75% of the 1996 reported costs pending disposition of the rehearing applications. In D.99-07-048, the Commission granted rehearing for the purpose of recalculating the 1996 implementation cost surcharge; reconsidering the appropriate mechanism for applying the interim customer surcharge; and adopting a means for transmitting the interim surcharges collected by the CLCs to Pacific and Verizon without compromising proprietary and confidential information. Pursuant to Ordering Paragraph (OP) 4 of D.99-07-048, Verizon filed complete cost schedules on August 25, 1999 detailing the actual implementation costs of $15.4 million incurred, by year, between January 1, 1996 and December 31, 1998 (see Attachment 3 of this decision). Costs incurred during 1999 were not included, nor any costs incurred prior to 1999 for projects that were not completed at the time of filing.

In response to the directives of D.99-07-048, the ALJ convened a prehearing conference (PHC) on September 29, 1999 to establish a procedural schedule for a reasonableness review of implementation costs and to reconsider

[2] For consistency, subsequent references in this order to GTEC will use its current corporate name of Verizon.

an appropriate cost recovery mechanism. The ALJ's October 13, 1999 ruling established a schedule for Verizon to file a report on the reasonableness of its costs and for parties' replies, as well as for discovery-related matters.

II. Verizon's Case-in-Chief

On December 20, 1999, Verizon filed its Report on Implementation Cost Recovery, including the prepared testimony of five witnesses. Verizon's costs covered three categories: (1) development of the infrastructure to support access to Operations Support Systems; (2) development of processes and procedures to implement local competition; and (3) related training of CLC representatives and Verizon personnel involved in the provision of service to benefit CLC end users. Verizon lowered its initial claim for cost recovery to $12.4 million as a result of information developed through preliminary discovery, plus $0.8 million in interest since the time the costs were incurred, for a total of $13.3 million. Verizon accrued interest charges on the balance in the memorandum accounts based on the most recent three-month commercial paper rate.

Verizon's testimony addressed the issue of double recovery to show that the costs included in its memorandum account would not also be recovered through prices for nonrecurring rate elements for wholesale services. Although Verizon's witness acknowledged that costs incurred during 1996 as implementation costs had been included in Verizon's unbundled network element (UNE) cost study in OANAD, he also proposed a means of removing them from the UNE cost study to avoid double recovery.

Attached to its witnesses' prepared testimony, Verizon included complete cost schedules, detailing its recorded implementation costs for 1996-98. A summary of the costs assigned to each project category, and a description of the

categories is set forth in Attachment 2 of this decision. Verizon sought to recover these costs, levied on a per-line basis to each customer regardless of class.

III. Positions of Other Parties

The active parties in the proceeding undertook discovery, but only the Office of Ratepayer Advocates (ORA) submitted testimony in response to Verizon's direct showing. ORA opposes any explicit recovery of Verizon's claimed implementation costs, arguing that Verizon's costs have not been properly documented, that any recovery of implementation costs should be treated as a wholesale pricing issue, as in OANAD, rather than as an end-user surcharge, and that any cost recovery, if allowed at all, should be limited to 50% of the requested amount.

The remaining parties entered into a settlement agreement with Verizon. The assigned ALJ agreed to the active parties' request to defer the schedule to file replies to Verizon's showing to permit parties to pursue settlement discussions. The active parties began settlement discussions and reached an agreement in principle. On November 17, 2000, Verizon served notice of a settlement conference to be held on December 1, 2000 pursuant to Rule 51.1 of the Commission's Rules of Practice and Procedure. At the settlement conference, a copy of a draft settlement agreement was distributed and discussed. Modifications to the draft were made as a result of those discussions. On December 1, 2000, the active parties (except for ORA)[3] signed a Settlement

[3] The parties sponsoring the Settlement Agreement are Verizon, AT&T Communications of California, Inc. (AT&T), MCI Worldcom (now known as "Worldcom, Inc.), and The Utility Reform Network (TURN).

Agreement. On April 23, 2001, the settling parties filed their Joint Motion seeking approval of the Settlement Agreement.

IV. Terms of the Proposed Settlement

Under the Settlement terms, Verizon would recover costs totaling $12.0 million, including principal and interest, over a two-year period, beginning January 1, 2002. The amount would be recovered through Verizon's Schedule Cal P.U.C. No. A-38. Billing Surcharge Mechanism applicable to local exchange, toll, and access billings and would result in a surcharge of approximately 0.28% if calculated based upon the most recent billing base approved. The actual surcharge factor, however, would be based on the years 2002 and 2003 billing bases approved by the Commission in Verizon's Annual Price Cap filing.

The Settlement is not confined to the implementation costs included in Verizon's December 20, 1999 filing; it includes additional Local Competition Implementation costs, as the Commission has defined them, incurred by Verizon during 1998 and 1999, as well as five new projects for which Verizon incurred costs during 2000. The Settlement also includes implementation costs incurred as a result of Commission or FCC orders issued before November 17, 2000. The Settlement also includes OSS enhancement or modification costs incurred during 1999 and 2000, even if they do not satisfy the Commission's definition of implementation costs.

The Settlement, however, specifically excludes costs of permanent number portability for which there is a separate recovery mechanism. It also excludes costs of implementing line sharing as described in the FCC's December 9, 1999 Advanced Services Order, Public Education Programs associated with overlays, 1,000-block number pooling, and implementing costs as defined by the Commission resulting from FCC or Commission orders issued after

November 17, 2000. Parties to the Settlement Agreement take no position about the ultimate recoverability of this latter group of costs. The Settling Parties agree, however, that the Settlement Agreement does not preclude Verizon from seeking recovery (nor other parties from opposing recovery) for OSS enhancement or modification costs incurred after 2000.

Only ORA filed a response to the proposed Settlement. ORA stated it could not support the Settlement absent a requirement precluding Verizon from seeking any further explicit recovery of any asserted "local competition implementation costs" in the future. ORA opposes allowing Verizon to return to the Commission and seek yet more money for further claimed one-time extraordinary implementation costs incurred after January 1, 2001, arguing that any infrastructure changes required after 2000 to support competition must necessarily be viewed as upgrades to previously installed systems and, as such, ordinary and ongoing costs of doing business. If the Settlement is modified to address this concerns ORA will drop its opposition.

In its June 4, 2001 reply to ORA, Verizon underscores the legality of considering future cost recovery, claiming there is no basis for treating it differently than Pacific, which was permitted to seek recovery of costs stemming from Commission or FCC orders issued on or after April 18, 2000.

V. Discussion

A. Framework for Reviewing the Settlement

Rule 51.1(e) of the Commission's Rule's of Practice and Procedure provides that the Commission "will not approve stipulations or settlements, whether contested or uncontested, unless the stipulation or settlement is reasonable in light of the whole record, consistent with the law, and in the public interest."

B. Reasonableness of Recovery Amount

We conclude that Settlement recovery amount of $12.0 million fairly balances the opposing interests of Verizon, consumers and competitors, favoring either no cost recovery or less recovery than Verizon requested. The settlement amount is below the $16.3 million in actual implementation costs that Verizon claims it incurred through 1999. The settlement amount also excludes interest charges on amounts incurred beginning in 1996 while delaying the commencement of recovery until 2002.

In addition, Verizon gives up its claim to recover any additional implementation costs beyond the $12 million that it otherwise could seek to recover based on Commission or FCC orders issued prior to November 17, 2000.

Although the opposing parties (other than ORA) reached settlement without submitting testimony proposing alternative recommendations in response to Verizon's December 20 filing, the opposing parties did engage in extensive discovery, probing the details of Verizon's showing. The parties engaged in settlement discussions after discovery was completed. Settlement was reached after opposing parties had been able to assess the strengths and weaknesses of their respective cases.

While the $12 million settlement amount does not equate to a disallowance as large as opposing parties might have sought in litigation, it represents a reasonable compromise of opposing interests. We make this judgment based upon the framework for evaluating settlements discussed previously, weighing the trade-off relating to the risk, expense, complexity, and likely duration of further litigation of Verizon's implementation cost recovery versus the amount of the settlement compared to Verizon's original proposal.

Although the adopted settlement of Pacific's implementation costs approved in D.00-09-037 is not precedential here, it is informative to note that Verizon's settlement amount compares favorably with the amount approved for Pacific. Pacific's recovery amount approved for implementation costs equates to an approximate surcharge of 0.737% per year for two years. Verizon's proposed settlement amount before us here equates to a surcharge of only 0.28% for two years.

C. Reasonableness of Recovery Method

The Settlement Agreement includes a specific amount to be recovered, by year, as well as the means for implementing it. Thus, this Settlement Agreement also conveys sufficient information to permit the Commission to discharge its regulatory obligations.[4]

The Settlement Agreement provides that the amount of $12.0 million will be recovered over two-years, beginning January 1, 2002. For each of the two years, the recovery will be by a surcharge calculated using the billing base approved in Verizon's Annual Price Cap filing for that year. The surcharge percentage, as calculated, shall be applied to Verizon's bills for toll, exchange, and access services, as described in Schedule 38 of Verizon's tariffs.

We conclude that the two-year recovery period is reasonable. Moreover, Verizon's existing surcredits that carry over into the years 2002 and

[4] In D.93-02-056, the Commission concluded that inclusion of specific rates in the settlement there provided a basis for its findings:

> The Settlement Agreement, containing as it does specific rates to be applicable . . .conveys sufficient information to permit the Commission to discharge its future regulatory obligations with respect to the parties to the instant proceeding.

2003 are great enough to more than offset the proposed surcharges for implementation cost recovery. Approval of the Settlement Agreement, therefore, will not result in a net surcharge on customer bills. Shortening the recovery time would likely cause the surcharge to exceed the scheduled surcredits for 2001. Lengthening the time for recovery could have raised potential issues of carrying charges that may have resulted in a higher settlement amount. Thus, the two-year recovery period strikes a reasonable balance.

Spreading the recovery over all three major groups of services in Verizon's Schedule No. 38 Billing Surcharge (i.e., local, toll, and access) is also reasonable. The larger the billing base, the smaller the per-customer surcharge, with less effect on individual customers. Although AT&T and Worldcom do not agree that costs of implementing local competition should be borne by long distance carriers, especially as it negatively impacts the legal requirement for cost-based access, other aspects of the settlement led to a compromise on this position. These aspects include the efficiency of the collection methodology.

In D.98-11-066, the Commission sought to extend implementation cost recovery to CLCs and their customers through the use of a per-line surcharge as the recovery mechanism. Following applications for rehearing of D.98-11-066 however, the Commission reconsidered its plan to use a per line surcharge as the recovery mechanism. The Commission agreed that a clearer definition was needed of the lines to which the surcharge should apply. The Commission also agreed that a per-line surcharge remitted by the CLCs to Pacific and Verizon would reveal proprietary CLC information – - the number of lines CLCs are serving - - to their ILEC competitors. If the transmission of the CLC's surcharge funds were to be managed by the ILEC, then carriers would have to report their revenues to the ILEC to verify that it was receiving the correct amounts. Carriers

consider their revenues, like their number of access lines, to be proprietary. The use of the Schedule 38 surcharge/surcredit in Verizon's tariffs as a recovery mechanism, however, avoids the problems of disclosing proprietary information or of requiring that the Commission manage the transmission of funds.

TURN believes that the ideal would be to use the most diverse billing base possible, including that of CLCs, to spread recovery beyond just the ILEC customers. That goal is accomplished in part by the inclusion of resold services in the Schedule 38 mechanism, although resale billings to CLCs are small. Further, by applying the surcharge to access, the funding base is more diversified and reaches corporations that have relatively large CLC operations. In light of the problems with using a surcharge on all retail revenues or any other method that proportionately would reach CLCs and their customers, using a Schedule 38 surcharge applied to exchange, toll and access as provided in the Settlement is a reasonable cost recovery mechanism.

D. Conclusion

In summary, we conclude that the Settlement Agreement conforms with Rule 51 of the Commission's Rules of Practice and Procedure, is reasonable in light of the whole record, consistent with law, and is in the public interest. The Settlement Agreement avoids the complexity, uncertainty, and extensive use of resources that would likely result from litigation of all of the issues in dispute among the active parties relating to Verizon's implementation cost recovery.

We have considered the objections raised by ORA, but do not find ORA's objections to provide a basis warranting denial of the proposed Settlement. ORA's only objection to the Settlement concerned whether its adoption adequately "closes the door" on further attempts by Verizon to seek explicit recovery for asserted costs to implement local competition. Yet, the

Settlement does provide significant closure regarding Verizon's ability to seek future cost recovery of implementation costs. For example, the Settlement precludes Verizon from seeking further cost recovery for any order of the Commission or the FCC predating November 17, 2000 (the date that parties reached an agreement in principle). In addition, OSS enhancement or modification costs incurred through the end of 2000 (even if such costs do not qualify as implementation costs) are covered under the Settlement. Accordingly, such costs cannot be recovered through any other means, including through wholesale or retail rates.

Moreover, while the Settlement does not bar possible recovery of implementation costs resulting from Commission or FCC Orders issued after November 17, 2000, such future recovery is not assured. Parties retain the right to oppose any future attempts to seek such cost recovery and to litigate such costs as necessary. We also observe that a similar provision was granted in the Settlement Agreement for Pacific, permitting it to seek future cost recovery for costs arising out of regulatory orders issued on or after April 18, 2000. Although the Settlement Agreement adopted for Pacific's implementation costs is not precedential for Verizon, we see no particular reason to treat Verizon differently from Pacific with respect to this point.

In consideration of these factors, we find the Settlement Agreement, taken in its totality, provides for a reasonable resolution of the issues relating to the amount and the manner of Verizon's recovery of implementation costs within the scope of this proceeding. Accordingly, the Settlement Agreement is approved. Verizon shall be authorized to begin recovering the $12 million allowance on January 1, 2002 over a two-year period, through Verizon's

Schedule Cal P.U.C. No. A-38 surcharge mechanism as set forth in the order below and consistent with the terms of the Settlement Agreement.

VI. Comments of Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Opening comments were filed on September 5, 2001. We have reviewed the comments, and taken them into account, as appropriate, in finalizing this order.

Findings of Fact

1. Verizon has been authorized to seek recovery of prudently incurred local competition implementation costs as prescribed by D.96-03-020, D.98-11-066, and D.99-07-048.

2. Verizon presented documentation in its August 25, 1999 filing to support recovery of $15.4 million in implementation costs incurred over three years (1996-1998), reflecting the costs as summarized in Attachment 3 of this order.

3. The active parties in this proceeding undertook extensive discovery and conducted depositions after receipt of Verizon's case in chief for its implementation cost recovery filed on December 20, 1999 in which Verizon lowered its recovery amount to $13.3 million, including interest.

4. The active parties in the implementation cost proceedings subsequently entered into settlement discussions with Verizon regarding its case-in-chief and signed a Settlement Agreement on December 1, 2000, as set forth in Attachment 1.

5. The Settlement would set Verizon's recovery amount for local competition implementation costs at $12.0 million, including principal and interest, to be recovered over two years beginning on January 1, 2002, through Verizon's

Schedule No. 38 Billing Surcharge applicable to exchange, toll, and access billings. The $12.0 million recovery amount covers those costs defined in Section 12 of the Settlement.

6. Based upon the most recently approved billing base, the Schedule 38 surcharge to recover the settlement amount would be 0.28%, although the actual surcharge amount will depend on the billing base approved for the years 2002 and 2003.

7. The surcredits that will be available to Verizon during 2002 and 2003 are expected to exceed the amount of the surcharge for recovery of the $12.0 million implementation costs, resulting in no net increase in the customer surcharge.

8. The Settlement recovery amount of $12.0 million would cover any amounts incurred through 1999 and subsequent years as a result of Commission or FCC orders issued before November 17, 2000, except for the specific categories of excluded costs identified in the Settlement.

9. The parties sponsoring the Settlement have been actively involved in reviewing and testing Verizon's December 20, 1999 case-in-chief filing.

10. The Settlement's recovery amount is less than the amount for which Verizon sought to justify recovery in its case-in-chief, but is more than the amount that opposing sponsoring parties could have proposed if the case was to be litigated.

11. TURN was opposed to any implementation cost recovery by Verizon prior to the Settlement, but entered into the Settlement in view of the Commission's previously adopted policy allowing for some cost recovery to be considered.

12. The sponsoring parties representing the interests of long distance carriers disagreed in principle that costs of local competition should be borne by long

distance carriers, but compromised on this position in view of the overall favorable terms of the Settlement.

13. The adoption of the settlement will avoid the risk, expense, and complexity of further litigation of Verizon's implementation cost.

14. ORA's objections to the settlement do not provide a sufficient basis to reject the settlement.

Conclusions of Law

1. The Settlement Agreement conforms with Rule 51 of the Commission's Rules of Practice and Procedure, and is reasonable in light of the whole record, consistent with law, and in the public interest.

2. The Settlement Agreement governing recovery of Verizon's implementation costs for local competition, as reproduced in Attachment 1 should be adopted.

3. Verizon should be authorized to recover $6 million per year in local competition implementation costs, including interest, over a two-year period beginning January 1, 2002, for a total of $12 million, through Verizon's Schedule No. 38 billing surcharge applied to exchange, toll, and access services in accordance with the terms outlined in the Settlement Agreement.

4. No provision of the Settlement Agreement is precedential for purposes of any future or concurrent proceeding.

O R D E R

IT IS ORDERED that:

1. The Settlement Agreement, set forth in Attachment 1 herein, is hereby approved and adopted.

2. Verizon California, Inc. (Verizon) is authorized to include an implementation cost surcharge in its Annual Price Cap filing beginning January 1, 2002 to recover $6 million per year for a two-year period, for a total of $12 million, to be applied to exchange, toll, and access services pursuant to Schedule CA. PUC No. 38 -Billing Surcharges of Verizon's tariffs.

3. The surcharge for the approved recovery amount shall be calculated as a percentage using the billing bases approved in Verizon's 2002 and 2003 Annual Price Cap filings, respectively.

This order is effective today.

Dated September 20, 2001, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
RICHARD A. BILAS
CARL W. WOOD
GEOFFREY F. BROWN
Commissioners

ATTACHMENT 1

SETTLEMENT AGREEMENT

NOTE: See CPUC Formal Files for Attachments 1-3.

ATTACHMENT 2

VERIZON CALIFORNIA INC.
LOCAL COMPETITION IMPLEMENTATION COSTS

ATTACHMENT 3

GTE CALIFORNIA
LOCAL COMPETITION IMPLEMENTATION COSTS